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ACTUARIAL GUIDELINE 1c

INTERPRETATION OF THE CALCULATION OF THE SEGMENT LENGTH WITH RESPECT TO THE LIFE INSURANCE POLICIES MODEL REGULATION UPON A CHANGE IN THE VALUATION MORTALITY RATES SUBSEQUENT TO ISSUE

I. Background

Some states have revised their regulation permitting the use of the 2001 CSO Preferred Class Structure Mortality Table so that at the company's option it might be used to value a policy on a plan which was previously approved for issue based on valuation using the 2001 CSO Mortality Table. A company making this election would be changing the valuation mortality rates. It is also the case that use of the 2001 CSO Preferred Class Structure Mortality Table is predicated upon the block of policies initially, and annually thereafter, satisfying certain requirements with respect to the present value of death benefits over certain future periods. If these requirements are not satisfied at some point in the future, the company must change to a table for which the requirements are satisfied. For example, this could mean changing from the super preferred nonsmoker table to the preferred nonsmoker table or maybe from the preferred smoker table to the smoker table. Although a non-elective change, this is also a change in the valuation mortality rates.

Section 4B of the Valuation of Life Insurance Policies Model Regulation defines the "Contract Segmentation Method" in which segments are to be calculated using the valuation mortality rates for deficiency reserves. Thus, potentially either of the two examples given above could trigger a recalculation of the valuation segments at the time the valuation mortality rates are changed. The purpose of this guideline is to prescribe which circumstances involving a change to the valuation mortality rates, require a recalculation of the segments and which do not.

The Valuation of Life Insurance Policies Model Regulation was adopted, in part, to stop the use of high net premiums late in the policy's life from unduly influencing the level of reserves early in the policy's life ("postfunding"). The contract segmentation method was the answer devised to control this. After the adoption of this regulation, companies incorporated the establishment of the segment lengths into the policy design process based on the valuation mortality expected to be used. Now it is seen that there are circumstances in which it may be necessary or desirable to change valuation mortality after issue. But if it triggers a segment recalculation then there could be unintended, undesirable results.

This guideline classifies the circumstances involved in changes to valuation mortality rates into two categories: those where deliberately designed postfunding is less likely so no segment recalculation is prescribed, and those where such postfunding is more possible so segment recalculation is required. In general, non-elective valuation mortality changes require no segment recalculation, while elective valuation mortality changes are divided into those on plans filed for approval before the adoption of this guideline and those filed after adoption. To preclude enhancing postfunding by changing valuation mortality after a plan is approved, recalculation of segments is required if the change is elected on plans filed after adoption of this guideline, but is not required for plans filed before.

II. Scope

This guideline is effective December 31, 2008.

III. Text

A. For policies subject to a non-elective change in valuation mortality rates:

For policies which were the subject of a non-elective change in valuation mortality rates because the requirements for continued use of the prior rates were no longer satisfied, Section 4B of the Valuation of Life Insurance Policies Model Regulation shall be interpreted so that the segments need not be recalculated.

B. For policies subject to a company election to substitute the 2001 Preferred Class Structure Table for the 2001 CSO Mortality Table:

1. For policies issued on a policy form filed for approval prior to [January 1, 2009], Section 4B of the Valuation of Life Insurance Policies Model Regulation shall be interpreted so that the segments need not be recalculated.

2. For policies issued on a policy form filed for approval after [January 1, 2009], Section 4B of the Valuation of Life Insurance Policies Model Regulation shall be interpreted to require that the segments be recalculated using the new valuation mortality rates.

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